

# Office of Inspector General



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Audit Report No. 03-037

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The FDIC's Implementation of the USA  
PATRIOT Act



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**Federal Deposit Insurance Corporation**

Washington, D.C. 20434

Office of Audits  
Office of Inspector General

**DATE:** September 5, 2003

**TO:** Michael J. Zamorski, Director  
Division of Supervision and Consumer Protection



**FROM:** Russell A. Rau  
Assistant Inspector General for Audits

**SUBJECT:** *The FDIC's Implementation of the USA PATRIOT Act*  
(Audit Report No. 03-037)

This report presents the results of the Office of Inspector General's (OIG) audit of the Federal Deposit Insurance Corporation's (FDIC) implementation of the *United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, Public Law 107-56 (USA PATRIOT Act, hereafter referred to as the PATRIOT Act). The overall objective of this audit was to determine whether the FDIC has developed and implemented adequate procedures to examine financial institutions' compliance with the PATRIOT Act. To accomplish our objective, we reviewed actions that the FDIC's Division of Supervision and Consumer Protection (DSC)<sup>1</sup> has taken to implement the Act.

Appendix I of this report discusses our objective, scope, and methodology in more detail. Appendix V and Appendix VI provide the acronyms and a glossary of terms used in this report, respectively.

## BACKGROUND

Under the PATRIOT Act, the Secretary of the Treasury (Treasury Department)<sup>2</sup> continues efforts to combat the corruption of United States financial institutions<sup>3</sup> for money laundering purposes. According to federal law, money laundering is the flow of cash or other valuables derived from,

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<sup>1</sup>The FDIC's DSC, in conjunction with other federal and state regulatory agencies, examines financial institutions to ensure they are conducting business in compliance with consumer protection rules and in a way that minimizes risk to their customers and to the deposit insurance funds. There are five categories of examinations: Safety and Soundness, Community Reinvestment Act, Compliance, Information Technology, and Trust.

<sup>2</sup>For reporting purposes, we will refer to the Secretary of the Treasury as the "Treasury Department" rather than "Secretary" or "Treasury."

<sup>3</sup>Financial institutions under the Bank Secrecy Act of 1970 and the PATRIOT Act include federally insured institutions such as banks, thrifts, and credit unions; and other financial service providers such as brokers or dealers in securities or commodities; issuers, redeemers, or cashiers of travelers' checks or money orders; travel agencies and loan or finance companies; insurance companies; pawnbrokers; telegraph companies; and the United States Postal Service.

or intended to facilitate, the commission of a criminal offense.<sup>4</sup> The PATRIOT Act broadens authority and required regulations to combat money laundering that were already established under the Bank Secrecy Act (BSA)<sup>5</sup> of 1970, codified to 31 U.S.C. Section 5311 et seq. by specifically amending that Act. The BSA's implementing regulation, 31 Code of Federal Regulations (C.F.R.) 103, is used to aid law enforcement agencies in the investigation of suspected criminal activity, ranging from income tax evasion to money laundering by organized crime. Congress enacted the BSA to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity.<sup>6</sup>

The BSA consists of two parts—Title I, Financial Recordkeeping and Title II, Reports of Currency and Foreign Transactions.

- Title I authorizes the Treasury Department to issue regulations requiring insured financial institutions to maintain certain records related to financial transactions.
- Title II directs the Treasury Department to prescribe regulations governing the reporting of certain transactions by and through financial institutions in excess of \$10,000 into, out of, and within the United States. A financial institution must file a Currency Transaction Report (CTR) with the Internal Revenue Service for each cash transaction over \$10,000 or multiple cash transactions by an individual in one business day aggregating over \$10,000.<sup>7</sup>

### **PATRIOT Act Expands BSA Requirements**

The PATRIOT Act expands the Treasury Department authority to regulate the activities of United States financial institutions, particularly their relations with individuals and entities with foreign ties.

More specifically, the PATRIOT Act:

- Expands requirements under the BSA, including requirements related to due diligence<sup>8</sup> for certain types of bank accounts, including correspondent<sup>9</sup> and

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<sup>4</sup>More specifically, money laundering is the process by which criminals or criminal organizations seek to disguise the illicit nature of their proceeds by introducing them into the stream of legitimate commerce and finance.

<sup>5</sup>The Bank Secrecy Act of 1970, also known as the Currency and Foreign Transactions Reporting Act, requires financial institutions to maintain appropriate records and file certain reports that are used in criminal, tax, or regulatory investigations or proceedings.

<sup>6</sup>*Bank Secrecy Act/Anti-Money Laundering*, Comptroller's Handbook, dated September 2000.

<sup>7</sup>In addition, as noted in the OIG's report entitled *Examination Assessment of Bank Secrecy Act Compliance*, Audit Report Number 01-013, dated March 30, 2001, BSA requires financial institutions to file Suspicious Activity Reports (SARs) with the Treasury Department when suspected money-laundering activity or BSA violations occur.

<sup>8</sup>For the PATRIOT Act, due diligence includes policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering.

<sup>9</sup>An account established by a covered financial institution to receive deposits from, or make payments or other disbursements on behalf of, a foreign financial institution.

concentration<sup>10</sup> accounts; requirements related to verification of customer identification; and anti-money laundering procedures.

- Expands the United States anti-money laundering umbrella to industries not previously subject to this type of regulation, such as other service providers that are not insured by the FDIC, including redeemers and sellers of money orders and travelers' checks, check cashers, and currency retail exchanges.<sup>11</sup>
- Marks the first time the United States has taken its money laundering regulations offshore in order to monitor foreign branches of United States banks and foreign institutions operating in the United States.
- Expands criminal sanctions already included in the BSA by increasing civil and criminal penalties for money laundering.<sup>12</sup>

These provisions are intended to facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism.<sup>13</sup>

### **Title III of the PATRIOT Act**

The PATRIOT Act has 10 titles that relate to the prevention of money laundering and financing of terrorism. The scope of our audit covered 1 of those 10 titles—Title III, which is entitled International Money Laundering Abatement and Anti-terrorist Financing Act of 2001. Title III consists of 46 sections, which include provisions related to (1) international counter-money laundering and related measures, (2) BSA amendments and related improvements that supplement the United States' authority to detect money laundering provided under the BSA, and (3) currency crimes and protection. In addition, Title III provisions include requirements related to special due diligence, correspondent accounts, concentration accounts, verification of customer identification, and information sharing. Further, Title III places considerable responsibilities on insured depository institutions to monitor foreign entities and individuals and cooperate with law enforcement officials in a timely manner. Under Title III, the FDIC is responsible for monitoring compliance with the PATRIOT Act by the financial institutions that it supervises.<sup>14</sup>

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<sup>10</sup>Any internal account established by the bank to facilitate the processing and settlement of multiple or individual customer transactions with the bank.

<sup>11</sup>Before the PATRIOT Act, only insured institutions were required, by regulation, to file reports on suspicious activities. The PATRIOT Act amended the BSA to require all financial institutions, as defined by the BSA, to have a formal anti-money laundering program.

<sup>12</sup>Civil and criminal money penalties may be an amount equal to not less than 2 times the amount of the involved transaction, but not more than \$1 million, on any financial institution or agency that violates provisions of Title 31, U.S. Code, that (1) govern due diligence requirements for United States private banking and correspondent bank accounts involving foreign persons or (2) prohibit correspondent accounts with foreign "shell" banks.

<sup>13</sup>Terrorism includes acts that violate criminal laws of the United States, attempt to coerce civilians or the government, or involve some effect upon the government by mass destruction, assassination, or kidnapping.

<sup>14</sup>The FDIC is the primary federal regulator of state-chartered institutions that are not members of the Federal Reserve System (FRS). According to the FDIC's *Letter to Stakeholders*, 2nd Quarter 2003, the number of state-chartered institutions that are not members of the Federal Reserve System totaled 5,338.

## **The Treasury Department Has the Lead Role in Implementation**

The Treasury Department is assigned the vast majority of the tasks associated with implementing the PATRIOT Act and, accordingly, has the lead role in implementing the Act. The PATRIOT Act is implemented through the Treasury Department's rulemaking process. More specifically, the Treasury Department, through its Financial Crimes Enforcement Network (FinCEN), issues proposed, interim, and final rules to implement the Act.<sup>15</sup> Alternatively, the Treasury Department, through FinCEN, may issue joint rules with the:

- Office of the Comptroller of the Currency (OCC),<sup>16</sup>
- Office of Thrift Supervision (OTS),<sup>17</sup>
- Board of Governors of the Federal Reserve System (FRB),<sup>18</sup>
- FDIC,
- National Credit Union Administration (NCUA),<sup>19</sup>
- Commodity Futures Trading Commission (CFTC),<sup>20</sup> and
- Securities and Exchange Commission (SEC).<sup>21</sup>

## **DSC Monitors Institutions' Compliance**

The FDIC's authority to examine the financial institutions that it supervises for compliance with the PATRIOT Act, specifically, Title III provisions, derives from statutory authority and Treasury Department regulations. Section 8 of the Federal Deposit Insurance Act (FDI Act), codified to 12 U.S.C. 1818, requires the FDIC to:

- prescribe regulations requiring regulated institutions to establish and maintain procedures reasonably designed to ensure and monitor compliance with the BSA and
- review such procedures during the course of FDIC examinations.

Additionally, although overall authority for BSA enforcement and compliance remains with the Treasury Department, its regulations delegate authority to bank regulatory agencies, including the FDIC, to examine banks for compliance.

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<sup>15</sup>The Treasury Department's FinCEN, established in 1990, oversees and implements policies to prevent and detect money laundering. In addition, the administration of the BSA, which authorizes the Treasury Department to require financial institutions to file certain reports and keep certain records of financial transactions, (e.g., suspicious activity reports, currency transaction reports, reports of cross-border currency transportation, and reports relating to foreign bank and securities accounts), is the primary regulatory activity of FinCEN.

<sup>16</sup>OCC regulates national banks and federally chartered branches and agencies of foreign banks.

<sup>17</sup>OTS regulates savings and loan or savings associations and thrift holding companies.

<sup>18</sup>The FRB regulates state-chartered banks that are members of the FRS. The FDIC and the FRB coordinate guidance for the examination of state-chartered financial institutions with the Conference of State Bank Supervisors (CSBS).

<sup>19</sup>NCUA charters and supervises federal credit unions.

<sup>20</sup>CFTC regulates the commodity futures and option markets in the United States. A commodity futures contract is an agreement to buy or sell a specific commodity at a specific price in the future. An option on a futures contract gives the buyer the right to convert the option into a futures contract.

<sup>21</sup>SEC regulates the securities industry, including stock exchanges, broker-dealers, investment advisors, mutual funds, and public utility holding companies.

BSA violations are subject to supervisory enforcement actions such as Cease and Desist orders<sup>22</sup> as well as civil monetary penalties. For instance, the FDI Act authorizes the regulatory agencies to issue Cease and Desist orders. Those orders can be issued if a regulated institution fails to establish and maintain adequate procedures related to BSA or to correct problems with the procedures after an agency has notified the institution that problems exist. In addition, regulatory agencies may impose civil money penalties for violations of Cease and Desist orders.

Section 326.8(b) of the FDIC's rules and regulations, codified to 12 C.F.R. 326.8, requires FDIC-supervised institutions to develop and administer a program to ensure compliance with the BSA and its implementing regulation 31 C.F.R. 103. Financial institutions' boards of directors must approve the program and document that approval in writing. At a minimum, financial institutions must implement a program that includes: (1) a system of internal controls, (2) independent testing for compliance with the BSA and its implementing regulation 31 C.F.R. 103, (3) designation of the individual(s) responsible for coordinating and monitoring compliance with the BSA, and (4) training in BSA requirements for appropriate personnel.

Within the FDIC, examination authority has been further delegated to the DSC. According to the *FDIC Case Managers Procedures Manual*, the FDIC should incorporate a BSA review at each onsite examination, generally interpreted to mean each safety and soundness examination. In response to the BSA, the FDIC has developed comprehensive examination procedures to use during its safety and soundness examinations.<sup>23</sup> Those procedures are included in a DSC examination module, dated February 2001, and are used to determine whether financial institutions properly implement BSA provisions and to independently identify instances of potential money laundering. During safety and soundness examinations, DSC examiners are required to determine whether a financial institution's management has done the following:

- Established adequate policies and procedures in accordance with anti-money laundering laws and regulations.
- Developed a system to identify large currency deposits.
- Identified, investigated, and reported suspicious transactions.
- Assigned responsibilities for ongoing compliance with BSA and financial recordkeeping regulations to a qualified person.
- Established an adequate BSA training program for employees.
- Performed internal reviews and independent audits to identify potential deficiencies in the BSA program.

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<sup>22</sup>A Cease and Desist order is a formal enforcement action issued by financial institution regulators to a bank or affiliated party to stop an unsafe or unsound practice or violation. The order may be terminated when the bank's condition has improved and the action is no longer needed or the bank has materially complied with the terms of the order.

<sup>23</sup>DSC uses a risk-focused examination program designed to focus examination resources on areas that present the greatest risk to insured institutions. DSC examiners conduct a risk-scoping and pre-examination process to determine appropriate levels of risk to assign to each functional area, including BSA compliance. Based on that assessment, examiners determine the most appropriate examination plan for each financial institution.

A bank's failure to comply with the BSA or a bank's involvement in money laundering can endanger its reputation, impact its capital and earnings, negatively reflect on the bank's management, and result in regulatory sanctions. Examinations that identify cases in which a bank has knowingly and willfully violated the BSA are referred, at the recommendation of the FDIC's regional offices, directly to the Treasury Department and, in some instances, to a United States Attorney. In addition, to coordinate the investigation of possible criminal misconduct, DSC notifies the FDIC OIG of recommendations for financial institutions to file SARs or when DSC prepares a SAR.

To assist the DSC in its monitoring process, the FDIC issues regulations, Financial Institution Letters (FILs),<sup>24</sup> and other guidance to financial institutions that it supervises; updates FDIC examination and training materials; and ensures that DSC examiners are adequately trained to monitor compliance with the PATRIOT Act. In addition, the FDIC participates in interagency working groups that (1) coordinate with other regulatory agencies and (2) ensure consistency of examination procedures used to monitor compliance by state-chartered financial institutions.

## **RESULTS OF AUDIT**

The FDIC's existing BSA examination procedures either partially or fully cover six of the eight anti-money laundering subject areas required by Title III of the PATRIOT Act and do not address the remaining two areas included in Title III. (See Finding A—Bank Secrecy Act Examination Procedures Cover Some PATRIOT Act Requirements). With respect to those Title III provisions that require new or revised examination procedures, DSC has coordinated its efforts with other regulatory agencies and began drafting new or revised examination procedures in October 2002, as deemed necessary, to implement the provisions. DSC has continued its efforts to draft new or revised examination procedures with updates made to those procedures as recently as April 2003. However, DSC has not yet issued new or revised examination procedures because it either is waiting for the Treasury Department to issue final rules implementing Title III provisions or is coordinating the issuance of uniform procedures with an interagency steering committee. This delay in issuing procedures is particularly a concern where the Treasury Department issued final rules related to:

- the prohibition on U.S. correspondent accounts, actions to deter money laundering, and the improvement of information sharing (September 2002) and
- the verification of customer identification (May 2003).

At the time we completed our field work, DSC expected to issue new or revised interagency examination procedures no later than September 30, 2003, in accordance with a corporate performance objective described in Appendix I.<sup>25</sup> However, the lack of examination procedures to determine full compliance with Title III provisions limits assurance that DSC examiners are assessing institutions' full compliance with the PATRIOT Act and that the institutions are taking

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<sup>24</sup>The FDIC uses FILs to correspond with financial institutions that it supervises. FILs may be issued for a variety of reasons, including notification of PATRIOT Act requirements and other issues of principal interest to those responsible for operating a bank or savings association.

<sup>25</sup> DSC's response to our draft report, included as Appendix VII, indicated that the interagency procedures will be delayed beyond September 30, 2003.

steps to implement all Title III provisions that are intended to facilitate the highest level of prevention, detection, and prosecution of international money laundering and the financing of terrorism. (See Finding B—DSC’s Progress in Implementing New Examination Procedures).

## **FINDING A: BANK SECRECY ACT EXAMINATION PROCEDURES COVER SOME PATRIOT ACT REQUIREMENTS**

Some of the Title III provisions included in the PATRIOT Act expand existing requirements under the BSA. Because DSC’s examinations include procedures to determine compliance with the BSA, financial institutions regulated by the FDIC are already monitored to determine compliance with PATRIOT Act provisions, to some degree. As outlined below, BSA examination procedures partially cover subject areas included in five Title III Sections—312, 313, 319, 325, and 326. In addition, existing BSA examination procedures cover all requirements of the subject area in Section 352 of Title III. Accordingly, DSC will continue to use existing BSA examination procedures, included in its Examination Documentation (ED) Modules, as a foundation for its new or revised examination procedures to determine compliance with the PATRIOT Act, Title III provisions.

- Section 312—Special Due Diligence—BSA examination procedures include steps to review a bank’s due diligence on private banking customers and internal correspondent banking relationships. The April 2003 draft revisions that DSC has made to its examination procedures<sup>26</sup> based on PATRIOT Act provisions include steps for examiners to determine whether financial institutions implement due diligence policies, procedures, and controls.
- Sections 313 and 319—Prohibition on U.S. Correspondent Accounts—Existing BSA examination procedures include steps to evaluate the bank’s system to identify suspicious activity in foreign correspondent accounts. The April 2003 draft revisions to examination procedures based on PATRIOT Act provisions include steps for examiners to confirm that the financial institution has obtained required documentation on foreign correspondent accounts within 30 calendar days after the date the account is established. The documentation should verify that the foreign correspondent bank is not a foreign shell bank and that the U.S. correspondent account is not used to indirectly provide services to foreign shell banks. Documentation should also describe the bank’s procedures for closing or terminating foreign correspondent accounts, re-certifying required documentation, and responding to written requests from federal law enforcement officers.
- Section 325—Concentration Accounts—BSA examination procedures include steps to review a bank’s “special use” or “concentration” accounts. Those procedures include confirming that financial institutions assess the adequacy of internal controls

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<sup>26</sup>The FDIC began revising its examination procedures related to Title III provisions during October 2002, with most recent revisions made during April 2003. Those revisions have not yet been finalized and are being reviewed by and coordinated with the FDIC-FRS-CSBS Steering Committee For Risk-Focused Supervision Examination Procedures and Supporting Software. The FDIC’s participation on and results of the Steering Committee are discussed in detail in Finding B.

that have been implemented to ensure the proper use of special use/concentration accounts and reviewing the nature of account activity for any suspicious or unusual activity. The April 2003 draft revisions to examination procedures include steps for examiners to confirm that bank policy prohibits (1) customers from directing the movement of funds through special use accounts and (2) bank employees from disclosing the existence of a special use account to customers.

- Section 326—Verification of Identification—BSA examination procedures include steps for reviewing bank account opening procedures and customer due diligence guidelines. The April 2003 draft revisions to examination procedures due to PATRIOT Act provisions include steps for examiners to confirm that the financial institution’s board adopts a written customer identification program for new accounts that includes (1) required customer identification information, (2) identification verification procedures, and (3) recordkeeping and retention procedures.
- Section 352—Anti-money Laundering Programs—BSA examination procedures include steps for examiners to determine whether financial institutions have adopted a written anti-money laundering program. The procedures include steps to determine whether the programs contain a system of internal controls, an independent testing for compliance, a designated qualified individual responsible for coordinating and monitoring day-to-day compliance, and training for appropriate personnel. As of April 2003, DSC had not drafted any revisions to its current examination procedures that relate to anti-money laundering programs. DSC officials stated that no revisions are necessary to comply with Title III provisions.

Further, in instances in which the Treasury Department has issued final rules implementing the Title III provisions—Sections 313, 314, 319, and 326—DSC has issued FILs informing the institutions that it supervises of the new requirements. DSC has not issued FILs for those sections for which the Treasury Department has not issued final rules.

Appendix II provides a comparison of the BSA and Title III provisions, illustrates in detail how existing BSA examination procedures cover some of Title III’s requirements, and provides a description of expanded coverage, such as amending the FDI Act.

## **FINDING B: DSC’S PROGRESS IN IMPLEMENTING NEW EXAMINATION PROCEDURES**

DSC has not yet issued new or revised examination procedures to determine whether the financial institutions it supervises are complying with PATRIOT Act Title III provisions not fully covered by current BSA examination procedures. DSC has not done so even though the Treasury Department has issued final rulings for four such provisions. DSC has drafted new and revised examination procedures to implement Title III provisions. However, DSC is coordinating the issuance of the procedures with other regulatory agencies and an interagency steering committee. Thus, DSC does not have complete control over issuance of the interagency procedures. Until the procedures have been issued and fully implemented by examiners, DSC’s

assurance is limited that the financial institutions that it supervises are in compliance with the PATRIOT Act Title III provisions, except for the one Title III section that is fully covered by current BSA examination procedures.

DSC initiated its process to issue new and/or revised examination procedures addressing Title III provisions during October 2002 and has continually made updates to those procedures. The issuance of those procedures depends heavily on DSC's association and coordination with three external entities or groups:

- the Treasury Department;
- interagency working groups that have included representatives from the OCC, OTS, FRB, NCUA, CFTC, and SEC;<sup>27</sup> and
- the FDIC-FRS-CSBS Steering Committee For Risk-Focused Supervision Examination Procedures and Supporting Software, which is composed of representatives from the FDIC, FRB, and CSBS.

### **Treasury Department Progress Impacts the FDIC**

The timeliness of DSC's issuance of examination procedures related to implementing Title III provisions is dependent, in part, upon the Treasury Department, which is responsible for issuing rules (proposed, interim, and final) that provide guidance that financial institutions should use to implement Title III provisions. Those rules are published in the Federal Register. When published in the Federal Register, the rules provide specifics on the applicability of Title III provisions, institutions covered under the rules, the effective date of a rule, and an overview of comments received and considered before publication.

Title III of the PATRIOT Act consists of 46 sections. However, only 8 of those 46 sections relate to examination procedures. Of those eight sections, only seven require the FDIC to issue revised or new examination procedures to assess compliance with the Act. DSC's procedures for BSA compliance already include steps that fully cover requirements for one of the eight sections—Section 352-Anti-Money Laundering Programs. Those procedures are used to determine whether financial institutions have implemented adequate controls related to an anti-money laundering program.

Of the seven Title III sections that require the FDIC to issue revised or new examination procedures, 5 sections—312, 313, 319, 325, and 326—require revisions to procedures already included in BSA examinations. The remaining two sections—311 and 314—are new requirements and, accordingly, require the FDIC to issue new examination procedures.

- Section 311—Special Measures for Financial Institutions. This section gives the Treasury Department authority to designate a foreign jurisdiction, institution, class of transactions, or type of account as a “primary money laundering concern” and to

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<sup>27</sup>Agencies are not always included in discussions for all PATRIOT Act sections. They may be involved only in discussions that affect institutions that they supervise or apply to them in general.

impose certain “special measures” with respect to such jurisdiction, institution, class of transactions, or type of account. Those five special measures include (1) recordkeeping and reporting of certain financial transactions, (2) information relating to beneficial ownership, (3) information relating to certain payable-through accounts, (4) information relating to certain correspondent accounts, and (5) prohibitions or conditions on opening or maintaining certain correspondent or payable-through accounts. DSC’s draft examination procedures include steps for examiners to confirm that the financial institutions have taken appropriate steps to comply with the special measures imposed by the Treasury Department on one or more classes of transactions that are found to be of primary money laundering concern.

- Section 314—Cooperative Efforts to Deter Money Laundering.<sup>28</sup> This section requires the Treasury Department to issue regulations to encourage financial regulators and law enforcement officials to share information with financial institutions regarding persons reasonably suspected of money laundering activities. DSC’s draft examination procedures include steps for examiners to confirm whether financial institutions have programs to comply with Section 314(a) information requests, which include the following:
  - designation of an employee as the contact person responsible for handling Section 314(a) information requests,
  - procedures to ensure that all required records are searched, with positive hits reported to the Treasury Department’s FinCEN within designated timeframes, and
  - appropriate records to document search results.

Appendix III provides an analysis of the Title III sections that are applicable to the FDIC, the status of information provided to financial institutions that the FDIC supervises, and the status of DSC’s development or revision of examination procedures for those sections. Appendix IV provides an analysis of Title III sections applicable to the FDIC that do not require revision to existing or issuance of new examination procedures.

The Treasury Department has issued three final rules addressing four of the seven Title III sections that require DSC to take some type of action related to its examination procedures. In turn, DSC has issued FILs to institutions that inform them of PATRIOT Act requirements and the Treasury Department’s final rulings for those four sections. More specifically, DSC issued FILs related to Sections 313, 314, 319, and 326 of Title III. Although DSC has not issued FILs for the remaining three Title III sections that require action (Sections 311, 312, and 325), as previously discussed, it has taken steps towards revising examination procedures or developing new procedures related to those sections.

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<sup>28</sup>Title III Section 314 is also referred to as Information Sharing.

## **Interagency Working Groups and Steering Committee Also Play a Role in the FDIC's Progress**

DSC is coordinating its issuance of examination procedures with other regulatory agencies and an interagency steering committee. DSC has participated in external interagency working groups that have included the OCC, OTS, FRB, NCUA, CFTC, and SEC. Since December 2001, those groups have met periodically to discuss the scope, terms, and timing of rules and regulations related to Title III provisions. In addition, the FDIC is a member of the FDIC-FRS-CSBS Steering Committee For Risk-Focused Supervision Examination Procedures and Supporting Software (Steering Committee). According to DSC Transmittal Number 98-097, dated December 3, 1998, the purpose of that interagency committee is to coordinate efforts to maintain interagency consistency in examination procedures and oversee the ongoing enhancements to the supporting software.<sup>29</sup>

The interagency working groups and Steering Committee have played pivotal roles in identifying new procedures and revising already existing examination procedures related to the Title III provisions. DSC made the most recent revisions to the procedures during April 2003 and is collaborating with the Steering Committee before issuing the final examination procedures for implementation. DSC will not formally issue and incorporate those procedures into its examination process until they have been reviewed and approved by the Steering Committee.

## **Lack of Examination Guidance Limits Assurance That Certain PATRIOT Act Provisions Are Being Effectively Implemented**

DSC has not issued or implemented examination procedures to ensure that financial institutions are complying with the requirements of four sections of Title III that the Treasury Department has finalized. Specifically, the Treasury Department issued final rules for three of these four sections in September 2002 as discussed below.

- Sections 313 and 319—Prohibition on U.S. Correspondent Accounts. The Treasury Department issued a final ruling on September 26, 2002, requiring that financial institutions take reasonable steps to ensure that they are not providing banking services directly or indirectly to foreign shell banks. As a result, the FDIC issued a FIL on December 11, 2002, informing institutions that it supervises of the new requirements for Sections 313 and 319. As discussed earlier, the intent of Sections 313 and 319 is to prevent money laundering and financing of terrorist activities through correspondent accounts maintained by U.S. financial institutions on behalf of foreign banks. According to the Treasury Department's final rule, which became effective October 28, 2002, for foreign accounts opened after October 2002, financial institutions had 30 days to comply—until the end of November 2002. For accounts opened before October 2002, financial institutions had until March 2003 to comply

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<sup>29</sup>Software products currently associated with examination procedures include Examination Documentation (ED), General Examination System (GENESYS), and Automated Loan Examination Review Tool (ALERT). The Steering Committee also includes a Subgroup on Risk-Focused Examination Procedures responsible for soliciting recommendations from field examiners, updating the content of examination modules, and distributing the revised modules to the field.

with the Treasury Department's final rule. However, DSC has not issued or implemented examination procedures to ensure compliance with Sections 313 and 319.

- Section 314—Information Sharing. The Treasury Department issued a final ruling which became effective on September 26, 2002, requiring that financial institutions that share information among each other and with federal law enforcement agencies comply with certain reporting and recordkeeping requirements. The final rule, among other things, establishes a mechanism for law enforcement authorities to communicate names of suspected terrorists and money launderers to financial institutions in order to promptly locate accounts and financial transactions. After the final ruling, the FDIC issued FILs on March 14, 2002, November 27, 2002, and December 10, 2002. The March 14, 2002 FIL discussed the interim ruling issued by the Treasury Department. The FIL issued on November 27, 2002, notified financial institutions of a temporary moratorium on compliance with Section 314 authorized by the FinCEN. The FIL dated December 10, 2002, informed financial institutions of the new requirements regarding information sharing. Specifically, the FIL stated that each financial institution should (1) designate a point of contact and provide that point of contact to the Treasury Department and (2) notify FinCEN of the financial institution's intent to share information on suspected terrorist and money laundering activities with other financial institutions. Neither the Treasury Department's final rule nor DSC's FILs designated a date upon which financial institutions had to comply with this ruling. Further, DSC has not issued or implemented examination procedures to ensure compliance with Section 314.

For the remaining section—Section 326—Customer Identification—the Treasury Department issued a final ruling on May 9, 2003, requiring institutions to adopt written identification programs. On May 27, 2003, the FDIC issued a FIL informing the institutions that the FDIC supervises of the new requirements regarding customer identification programs. As explained earlier, the section requires financial institutions to implement a customer identification program to verify the identity of customers who open new accounts. Financial institutions have until October 1, 2003 to comply with the rule by implementing a customer identification program. DSC has not issued or implemented examination procedures to ensure compliance with Section 326.

All four of the provisions are intended to facilitate the prevention, detection, and prosecution of criminal money laundering activities. For example, Sections 313 and 319 establish several regulatory mechanisms for controlling activity between U.S. financial institutions and foreign individuals or institutions. Specifically, the provision prohibits financial institutions from maintaining correspondent accounts with banks lacking a physical place of business and that are not subject to regulatory supervision. Section 314 encourages banks to share information among themselves and with law enforcement agencies concerning suspected money laundering and terrorist activities in order to facilitate the identification of accounts and transactions involving suspected terrorists and terrorist groups. Finally, Section 326 is intended to help financial institutions identify and maintain records of suspected terrorist or terrorist groups. Because of the significance of these provisions, further delays in implementation of examination procedures limit assurance that sound programs have been established by FDIC-supervised institutions to assist in the identification of potential terrorist financing activities.

## CONCLUSION AND RECOMMENDATIONS

DSC's efforts to issue new and/or revised examination procedures that will assess financial institutions' compliance with the PATRIOT Act provisions included in Title III are, to some degree, dependent upon other entities and the DSC's participation on the Steering Committee. Further, DSC's efforts to ensure its examination procedures are consistent with those issued by other members of the Steering Committee are noteworthy. However, DSC could (1) accelerate its issuance of examination procedures (even for interim purposes) that relate to Title III provisions for which the Treasury Department has already issued final rulings—Sections 313, 314, 319, and 326—and (2) establish a mechanism to ensure that for future final rulings issued by the Treasury Department, the Corporation can more expeditiously issue examination guidelines concurrently with the Treasury Department's rulings. The significance of the PATRIOT Act provisions included in Title III, which are meant to assess vulnerabilities to terrorists' financing of activities worldwide, necessitate that financial institutions' compliance with those provisions is a priority. Timely issuance of examiner guidance will help ensure institutions' full compliance with PATRIOT Act provisions.

We recommend that the Director, DSC:

- (1) Issue interim examination procedures for those sections for which the Treasury Department has already issued final rules—Title III Sections 313, 314, 319, and 326.
- (2) Work with the FDIC-FRS-CSBS Steering Committee For Risk Focused Examination Procedures and Supporting Software to issue examination guidelines concurrently with the Treasury Department's issuance of final rules for institutions' implementation of Title III provisions.

## CORPORATION COMMENTS AND OIG EVALUATION

On August 26, 2003, the DSC Director provided a written response to the draft report. The response is presented in Appendix VII to this report. DSC management concurred with both recommendations.

**Recommendation 1: Issue interim examination procedures for those sections for which the Treasury Department has already issued final rules—Title III Sections 313, 314, 319, and 326.**

DSC agreed with this recommendation. DSC issued interim guidance on August 15, 2003, entitled Bank Secrecy Act Examination Procedures. The guidance, which was effective on the date of issuance, was distributed to all FDIC examiners.

This recommendation is considered resolved, dispositioned, and closed.

**Recommendation 2: Work with the FDIC-FRS-CSBS Steering Committee For Risk Focused Examination Procedures and Supporting Software to issue examination guidelines**

**concurrently with the Treasury Department's issuance of final rules for institutions' implementation of Title III provisions.**

DSC agreed with the recommendation. DSC is working with the FRB and the CSBS in the interagency examiner-guidance process. DSC further stated that the interagency Supervisory Process Committee suggested that interagency guidance be deferred for various reasons until after the committee's November 2003 meeting. These reasons included additional rulemaking issues related to the USA PATRIOT Act and the length of time required to update the ED module application. As a result, DSC immediately began the process of issuing interim guidance to DSC examiners. That guidance was issued August 15, 2003—46 days before the planned completion date of September 30, 2003. In addition, DSC has a representative member on the Supervisory Process Committee who will raise the interagency examination guideline recommendations contained in this report at the next scheduled committee meeting. DSC expects that action to be completed no later than March 31, 2004.

This recommendation is considered resolved, dispositioned, and closed.

A summary chart showing management's responses to all recommendations is presented in Appendix VIII.

## OBJECTIVE, SCOPE, AND METHODOLOGY

The overall objective of this audit was to determine whether the Federal Deposit Insurance Corporation (FDIC) has developed and implemented adequate procedures to examine financial institutions' compliance with the USA PATRIOT Act (PATRIOT Act). During this audit, we reviewed the FDIC's Division of Supervision and Consumer Protection's (DSC) efforts to implement the PATRIOT Act and revise its examination procedures to determine whether financial institutions comply with the PATRIOT Act.

To accomplish our objective, we held an entrance conference and interviews with DSC officials in Washington, D.C., and met with DSC officials periodically during the survey. Specifically, we interviewed officials in DSC's Special Activities Section who are responsible for coordinating and monitoring DSC's efforts related to implementing the PATRIOT Act. We also interviewed representatives of the FDIC's Legal Division in Washington, D.C. In addition, we provided a copy of our draft report to representatives from the United States Department of the Treasury, Office of Inspector General, to obtain comments on issues included in the draft report that relate to the Treasury Department.

Further, we reviewed the DSC memorandum entitled *FDIC-FRS-CSBS Steering Committee For Risk-Focused Supervision Examination Procedures and Supporting Software* to obtain an understanding of the purpose, composition, responsibilities, and relationship to revising current examination procedures and issuing new procedures. We also reviewed FDIC Financial Institution Letters (FILs) and DSC memoranda to obtain an understanding of guidance provided to FDIC-regulated institutions and DSC's safety and soundness examiners. The guidance related to examination procedures for the PATRIOT Act and Bank Secrecy Act (BSA) compliance.

To gain an understanding of examination procedures that the FDIC uses to determine compliance with the BSA and PATRIOT ACT, we reviewed the *DSC Manual of Examination Policies* which contain DSC policies and procedures related to safety and soundness examinations and its implementation of the BSA. More specifically, we reviewed examination procedures, included in the FDIC's examination module for Anti-Money Laundering/Bank Secrecy Act (February 2001), that are used during the FDIC's examinations of financial institutions to determine compliance with the BSA.

In addition, we reviewed examination procedures that DSC drafted in response to PATRIOT Act provisions. To determine the status of the FDIC's draft procedures related to the implementation of the PATRIOT Act, we reviewed procedures that the FDIC had drafted, as of April 2003, and provided to the FRB for review. We also gained an understanding of the process that the FDIC uses to issue new examination procedures or revise existing procedures.

Finally, we reviewed applicable Federal Register publications, current news articles, and other agency and regulator reports and related documents to gain an understanding of banking regulators' roles and responsibilities in implementing the PATRIOT Act; determine the status of the Treasury Department's rulemaking (proposed, interim, and final rules) related to the PATRIOT Act; and obtain an understanding of the PATRIOT Act.

We gained an understanding of the management control activities associated with the implementation of the PATRIOT Act by reviewing DSC's policies and examination procedures. Our testing for FDIC's compliance with laws and regulations was limited to those sections of the PATRIOT Act applicable to the FDIC. To determine the relationship between, and similar requirements of, the PATRIOT Act and the BSA, we reviewed pertinent sections of those Acts in detail. We also reviewed the OIG's audit report entitled *Examination Assessment of Bank Secrecy Act Compliance* (Audit Report Number 01-013, dated March 30, 2001). We reviewed that report to obtain an understanding of previous OIG audit work related to BSA.

In addition, we reviewed DSC's performance measures under the Government Performance and Results Act, Public Law 103-62 (GPRA). We determined that the FDIC has established a corporate performance objective related to the PATRIOT Act and identified key milestones for implementing the PATRIOT Act. Specifically, the performance objective includes the following:

- implement appropriate policy guidelines and examination procedures to ensure compliance with provisions of the PATRIOT Act with a planned completion date of September 30, 2003 and
- implement appropriate systems to capture and transmit financial institution contact information to the Financial Crimes Enforcement Network (FinCEN) on an ongoing basis.

The limited nature of the audit objective did not require that we assess the possibility for fraud and illegal acts, and no instances of potential fraud and illegal acts came to our attention. In addition, because the FDIC has not yet incorporated any new or revised examination procedures into its safety and soundness examinations, we did not verify computer-processed data.

We reviewed synopses of results of the interagency working groups that the FDIC has participated in and work related to the PATRIOT Act that the FDIC has undertaken. We also reviewed the Treasury Department's, including FinCEN's, Web site to obtain background information on the PATRIOT Act and BSA.

In addition, we coordinated with the United States General Accounting Office, the FDIC OIG Office of Investigations, the OIG Counsel, and the DSC Internal Control and Review Section to determine whether there were any previous or ongoing audits, reviews, or investigations related to the implementation of the PATRIOT Act. Based on those contacts, we determined that other than the OIG's BSA-related report referenced above, there was no prior or ongoing work related to the objective of this audit.

Further, we developed fact sheets on PATRIOT Act Title III sections that apply to the FDIC based on analyses provided by the OIG Counsel and the FDIC Legal Division. We asked the FDIC Legal Division and two DSC officials who were involved in the interagency discussions to review those fact sheets to determine the accuracy and applicability of data included in them. We revised those fact sheets, as appropriate, based on their comments.

We conducted the audit in accordance with generally accepted government auditing standards from April 2003 through June 2003.

## COMPARISON OF PATRIOT ACT AND BSA REQUIREMENTS

Title III Section <sup>a</sup>	Included in BSA Exam Procedures	PATRIOT Act Amendments to BSA
Section 311-Special Measures for Financial Institutions	No	Amends BSA to allow the Treasury Department to impose special measures related to foreign jurisdictions, financial institutions, and other accounts identified as primary money laundering concerns.
Section 312-Special Due Diligence	Yes	Amends BSA to require financial institutions that provide private banking accounts or correspondent accounts for foreign persons to establish due diligence procedures; and requires enhanced due diligence for certain correspondent and private banking accounts.
Section 313-Prohibition on U.S. Correspondent Accounts <sup>b</sup>	Yes	Amends BSA to prohibit financial institutions from providing correspondent accounts to foreign banks with no physical presence.
Section 314-Cooperative Efforts to Deter Money Laundering <sup>c</sup>	No	Requires the Treasury Department to issue regulations to encourage financial regulators and law enforcement officials to share information with financial institutions regarding persons reasonably suspected of money laundering activities.
Section 319-Forfeiture of Funds <sup>b</sup>	Yes	Amends BSA to require financial institutions that maintain correspondent accounts for foreign banks to maintain records regarding foreign banks.
Section 325-Concentration Accounts at Financial Institutions	Yes	Amends BSA to authorize the Treasury Department to issue regulations concerning the maintenance of concentration accounts by financial institutions.
Section 326-Verification of Identification	Yes	Amends BSA to require the Treasury Department to prescribe regulations to set minimum standards for identifying customers seeking to open accounts at financial institutions.
Section 327-Consideration of Anti-Money Laundering Record <sup>d</sup>	No	Amends the Bank Holding Company Act and Bank Merger Act to add a consideration factor for applications under those Acts.
Section 352-Anti-Money Laundering Programs <sup>d</sup>	Yes	Amends BSA to require every financial institution to establish anti-money laundering programs, and authorizes the Treasury Department to issue regulations for minimum standards.
Section 353-Penalties for Violations of Certain Recordkeeping Requirements <sup>d</sup>	No	Amends BSA civil and criminal penalty provisions to include violation of regulations issued under Section 21 of the FDI Act.
Section 354-Anti-Money Laundering Strategy <sup>d</sup>	No	Amends 31 U.S.C. §5341(b) to add money laundering related to terrorist funding to the list of items to be discussed.
Section 355-Authorization to Include Suspicions of Illegal Activity <sup>d</sup>	No	Adds a new section 18(w) to the FDI Act to permit any insured depository institution to disclose the possible involvement of “potentially unlawful activity.”

Source: OIG review of BSA examination procedures and PATRIOT Act Title III requirements.

<sup>a</sup>Some of the names of Title III Sections have been abbreviated for the purposes of this table.

<sup>b</sup>Sections 313 and 319 are usually referred to and discussed together because both sections amend 31 U.S.C. §5318.

<sup>c</sup>Cooperative Efforts to Deter Money Laundering is also referred to as Information Sharing.

<sup>d</sup>Sections 327, 353, 354, and 355 do not affect examination procedures. Section 352, although related to examination procedures, is fully covered by BSA procedures.

## ANALYSIS OF TITLE III SECTIONS APPLICABLE TO THE FDIC THAT RELATE TO EXAMINATION PROCEDURES

Title III Section	Name of Title III Section <sup>a</sup>	Status of Rule (Proposed/Interim /Final) <sup>b</sup>	FDIC's Communication to Financial Institutions	Section Requires New Procedures or Revisions to Existing Procedures	Status of FDIC Procedures	Comments
311	Special Measures for Financial Institutions	Proposed rule issued April 2003	No FIL <sup>c</sup>	New examination procedures	Revisions drafted April 2003 <sup>d</sup>	No final rule issued.
312	Special Due Diligence	Interim final rule issued July 2002	No FIL	Revisions to existing procedures	Revisions drafted April 2003	No final rule issued.
313/319 <sup>e</sup>	Prohibition on U.S. Correspondent Accounts/Forfeiture of Funds	Final rules issued September 2002 and December 2002 <sup>f</sup>	FIL for each section (313 and 319) issued December 2002	Revisions to existing procedures	Revisions drafted April 2003	For foreign accounts opened after October 2002, banks have 30 days to comply. For accounts opened before October 2002, banks have until March 2003 to comply.
314	Cooperative Efforts to Deter Money Laundering/ Information Sharing	Final rule issued September 2002	FILs issued March, November, and December 2002	New examination procedures	Revisions drafted April 2003	Establishes procedures that encourage information sharing between governmental authorities and financial institutions, and among financial institutions themselves. Financial institutions required to provide federal regulator with a point of contact for information requests.
325	Concentration Accounts at Financial Institutions	No rule issued	No FIL	Revisions to existing procedures	Revisions drafted April 2003	Banking regulators provided the Treasury Department a draft of proposed regulations that have not been published for comment.
326	Verification of Identification	Joint final rule issued-May 2003 <sup>g</sup>	FILs issued August 2002 and May 2003	Revisions to existing procedures	Revisions drafted April 2003	Financial institutions have until October 2003 to comply.
352	Anti-Money Laundering Programs	Interim rule- November 2002	No final rule, No FIL	Procedures already require programs.	Not applicable	Current BSA examination procedures already fully address anti-money laundering program concerns.

Source: OIG review of PATRIOT Act Title III; FDIC's FILs, BSA examination procedures, and draft PATRIOT Act examination procedures, as of April 2003; and applicable publications of the Federal Register.

<sup>a</sup>Some of the names of Title III Sections have been abbreviated for the purposes of this table. <sup>b</sup>Unless otherwise noted, the Treasury Department is responsible for issuing rules necessary for enacting the provisions and necessitating compliance by the regulators. <sup>c</sup>FDIC communicates proposed, interim, and final rules and other specific guidance through Financial Institution Letters (FIL). <sup>d</sup>DSC began drafting revisions to existing or new examination procedures during October 2002. The most recent revisions were made during April 2003. <sup>e</sup>The Treasury Department, FDIC, and the other regulatory agencies (Federal Reserve, Office of Thrift Supervision, Office of the Comptroller of the Currency, Securities and Exchange Commission, and Department of Justice) addressed rules for provisions 313 and 319 together. <sup>f</sup>Final rule issued in December 2002 extended the date for compliance to March 2003. <sup>g</sup>Final rule for Section 326 was issued jointly with Federal Reserve, Office of Thrift Supervision, Office of the Comptroller of the Currency, Securities and Exchange Commission, and Department of Justice.

**ANALYSIS OF TITLE III SECTIONS APPLICABLE TO THE FDIC THAT RELATE TO EXAMINATION PROCEDURES**

<b>Title III Section</b>	<b>Name of Title III Section<sup>a</sup></b>	<b>Status of Rule (Proposed/Interim /Final)<sup>b</sup></b>	<b>FDIC's Communication to Financial Institutions</b>	<b>Section Requires New Procedures or Revisions to Existing Procedures</b>	<b>Status of FDIC Procedures</b>	<b>Comments</b>
327	Consideration of Anti-Money Laundering Record <sup>b</sup>	Final rule not needed. Provision amended FDI Act.	FDIC issued FIL December 2001 and July 2002	Does not affect examination procedures. Refers to applications under Bank Merger Act.	Not applicable	FDI Act Section 18(c) amended. FDIC amended its Statement of Policy on bank mergers to consider anti-money laundering record of institutions requesting merger approval.
353	Penalties for Violations of Certain Recordkeeping Requirements	Final rule not needed. Provision amended BSA.	No final rule or FIL	Does not affect examination procedures.	Not applicable	Expands BSA civil and criminal penalty provisions to include violation of regulations issued under Section 21 of the FDI Act.
354	Anti-Money Laundering Strategy	Final rule not needed. Provision amended 31 U.S.C. 5341(b).	No action required	Does not affect examination procedures.	Not applicable	Added section to the Treasury Department's National Money Laundering Strategy.
355	Authorization to Include Suspicions of Illegal Activity	Final rule not needed. Provision amended FDI Act	No final rule or FIL	Does not affect examination procedures.	Not applicable	Section 18(w) of the FDI Act amended – Allows financial institutions to disclose potentially unlawful activity.

Source: OIG review of PATRIOT Act Title III; FDIC's FILs, BSA examination procedures, and draft PATRIOT Act examination procedures, as of April 2003; and applicable publications of the Federal Register.

<sup>a</sup>Some of the names of Title III Sections have been abbreviated for the purposes of this appendix.

<sup>b</sup>For Section 327 of Title III, the FDIC has issued a FIL discussing the significance of considering anti-money laundering laws and regulations in proposed merger transactions. Beginning January 1, 2002, the FDIC, in its evaluation of applications filed under Section 18(c) of the FDI Act, also known as the Bank Merger Act, began considering the anti-money laundering record of each involved insured depository institution in deciding the appropriateness of approving consent to merge.

**ACRONYMS**

<b>BSA</b>	Bank Secrecy Act
<b>C.F.R.</b>	Code of Federal Regulations
<b>CFTC</b>	Commodity Futures Trading Commission
<b>CSBS</b>	Conference of State Bank Supervisors
<b>CTR</b>	Currency Transaction Report
<b>DSC</b>	Division of Supervision and Consumer Protection (formerly the Division of Supervision)
<b>ED</b>	Examination Documentation Module
<b>FDI Act</b>	Federal Deposit Insurance Act
<b>FDIC</b>	Federal Deposit Insurance Corporation
<b>FIL</b>	Financial Institution Letter
<b>FinCEN</b>	Financial Crimes Enforcement Network
<b>FRB</b>	Board of Governors of the Federal Reserve System
<b>FRS</b>	Federal Reserve System
<b>NCUA</b>	National Credit Union Administration
<b>OCC</b>	Office of the Comptroller of the Currency
<b>OIG</b>	Office of Inspector General
<b>OTS</b>	Office of Thrift Supervision
<b>SAR</b>	Suspicious Activity Report
<b>SEC</b>	Securities and Exchange Commission
<b>PATRIOT Act</b>	USA PATRIOT Act (United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001)

## GLOSSARY

Term	Definition
<b>Bank Holding Company Act</b>	The principal purpose of the Act is to (1) regulate acquisition of control of banks by companies and individuals, (2) define and regulate the non-banking activities in which bank holding companies and foreign banking organizations with United States operations may engage, and (3) establish procedures for securing approval for bank mergers.
<b>Bank Merger Act</b>	The Bank Merger Act includes factors to consider in evaluating bank merger applications, including: (1) financial and managerial resources, (2) prospects of the existing and proposed institutions, and (3) convenience and needs of the community to be served. A merger that might substantially lessen competition or tend to create a monopoly may not be approved.
<b>Bank Secrecy Act</b>	Codified at 31 U.S.C. 5311-5330 and gives the Treasury Department broad powers to implement anti-money laundering regulations on financial institutions; such regulations are implemented by the Treasury Department through 31 C.F.R. 103. The Act consists of two Titles: Title I, entitled Financial Recordkeeping and Title II, entitled Reports of Currency and Foreign Transactions. Title I authorizes the Treasury Department to issue regulations that require insured financial institutions to maintain certain records. Title II directed the Treasury Department to prescribe regulations governing the reporting of certain transactions by and through financial institutions in excess of \$10,000 into, out of, and within the United States.
<b>Capital</b>	Bank capital performs several very important functions. It absorbs losses, promotes public confidence, restricts excessive asset growth, and provides protection to depositors and the FDIC insurance funds.
<b>Check Casher</b>	A person engaged in the business of a check casher (other than a person who does not cash checks in an amount greater than \$1,000 in currency or monetary or other instruments for any person on any day in one or more transactions).
<b>Commodity Futures Trading Commission</b>	Congress created the CFTC in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. The agency protects market participants against manipulation, abusive trade practices, and fraud. Through effective oversight and regulation, the CFTC enables the markets to serve better their important functions in the nation's economy—providing a mechanism for price discovery and a means of offsetting price risk.

## GLOSSARY

Term	Definition
<b>Currency Transaction Record</b>	A financial institution in the United States generally must file a currency transaction record for each transaction in currency over \$10,000. A transaction in currency is any transaction involving the physical transfer of currency from one person to another and covers deposits, withdrawals, and exchanges or transfers of currency or other payments. Currency is defined as currency and coin of the United States or any other country as long as it is customarily accepted as money in the country of issue.
<b>Division of Supervision and Consumer Protection (DSC)</b>	<p>The DSC promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised insured depository institutions. The mission of the DSC is to promote stability and public confidence in the nation's financial system by:</p> <ul style="list-style-type: none"> <li>• examining and supervising insured financial institutions to ensure they operate in a safe and sound manner, consumers' rights are protected, and FDIC-supervised institutions invest in their communities and</li> <li>• providing timely and accurate deposit insurance information to financial institutions and the public.</li> </ul>
<b>Earnings</b>	One of the key elements considered when assessing capital adequacy. Good earnings performance enables a bank to fund its growth and remain competitive in the marketplace while at the same time retaining sufficient equity to maintain a strong capital position.
<b>Examinations</b>	The FDIC, in conjunction with other federal and state regulatory agencies, examines financial institutions to ensure they are conducting business in compliance with consumer protection rules and in a way that minimizes risk to their customers and to the deposit insurance funds. The FDIC is the primary federal regulator of state-chartered banks that are not members of the FRS; the FRB regulates state-chartered, member banks; the OCC regulates nationally chartered banks; and the OTS regulates all federally insured thrifts, regardless of charter. The FDIC conducts five categories of examinations: Safety & Soundness, Community Reinvestment Act, Compliance, Information Systems & E-banking, and Trust of its institutions.

## GLOSSARY

Term	Definition
<b>FDIC Supervision</b>	<p>The FDIC's Supervision Program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised insured depository institutions.</p> <p>As supervisor, the FDIC performs safety and soundness examinations of FDIC-supervised institutions to assess their overall financial condition, management practices and policies, and compliance with applicable laws and regulations. Through the examination process, the FDIC also assesses the adequacy of management and internal control systems to identify and control risks. Procedures normally performed in completing this assessment may disclose the presence of fraud or insider abuse.</p> <p>The FDIC supervises FDIC-insured state-chartered banks that are not members of the FRS, described as state non-member banks. This includes state-licensed insured branches of foreign banks and state-chartered mutual savings banks. The FDIC also has special examination authority for state member banks that are supervised by the FRB, national banks that are supervised by the OCC, and savings associations that are supervised by the OTS. This authority is exercised in the FDIC's role as insurer of those institutions.</p>
<b>Federal Deposit Insurance Corporation (FDIC)</b>	<p>The FDIC's mission is to maintain the stability of and public confidence in the nation's financial system. To achieve this goal, the FDIC was created in 1933 to insure deposits and promote safe and sound banking practices.</p>
<b>Federal Reserve System</b>	<p>The Federal Reserve, the central bank of the United States, was founded by Congress in 1913 to provide the nation a safer, more flexible, and more stable monetary and financial system. The Federal Reserve is responsible for</p> <ol style="list-style-type: none"> <li>(1) conducting the nation's monetary policy;</li> <li>(2) supervising and regulating banking institutions and protecting the credit rights of consumers;</li> <li>(3) maintaining the stability of the financial system; and</li> <li>(4) providing certain financial services to the U.S. government, the public, financial institutions, and foreign official institutions.</li> </ol>
<b>Final Rule</b>	<p>Generally, issued to amend a C.F.R. by adding, removing, or revising text, makes a previously issued proposed rule final, or may take final action without a prior proposed rule being issued. Final rules are usually effective at least 30 days after the date of publication, in most cases; at least 60 days from after the date of publication for major rules; or on the date of publication in response to an emergency.</p>

## GLOSSARY

Term	Definition
<b>Financial Institution Letters</b>	Financial Institution Letters are addressed to the Chief Executive Officers of financial institutions, generally FDIC-supervised institutions, and may announce new regulations, special alerts concerning counterfeit financial institutions, new FDIC publications, and a variety of other matters of principal interest, including information related to the PATRIOT Act, to those responsible for operating a bank or savings association.
<b>FinCEN</b>	The Financial Crimes Enforcement Network, an office within the Office of the Under Secretary (Enforcement) of the Department of the Treasury.
<b>Foreign Bank</b>	Any organization that is organized under the laws of a foreign country; that engages in the business of banking; is recognized as a bank by the banking supervisory or monetary authority of the country of its organization or the country of its principal banking operations; and receives deposits during its regular course of business.
<b>Foreign Shell Bank</b>	A foreign bank without a physical presence in any country.
<b>Insured Depository Institution</b>	The term insured depository institution means any bank or savings association, the deposits of which are insured by the FDIC.
<b>Insured Non-Member Bank</b>	Any bank, including a foreign bank having a branch, the deposits of which are insured in accordance with the provisions of the Federal Deposit Insurance Act, which is not a member of the Federal Reserve System. The term does not include any institution chartered or licensed by the Comptroller of the Currency, any District bank, or any savings association.
<b>Interim Rule</b>	Interim rules may be issued without prior notice and are effective immediately. The interim rule is designed to respond to an emergency situation and is usually followed by a final rule document confirming that the interim rule is final, addresses comments received, and includes any further amendments.
<b>Internal Control</b>	Internal control is an integral component of an organization's management that provides reasonable assurance of achieving effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.
<b>Money Laundering</b>	In federal law, money laundering is the flow of cash or other valuables derived from, or intended to facilitate, the commission of a criminal offense. More specifically, money laundering is the process by which criminals or criminal organizations seek to disguise the illicit nature of their proceeds by introducing them into the stream of legitimate commerce and finance. Federal authorities attack money laundering through regulations, criminal sanctions, and forfeiture.

## GLOSSARY

Term	Definition
<b>National Credit Union Administration</b>	The National Credit Union Administration (NCUA) is the independent agency that charters and supervises federal credit unions. NCUA operates the National Credit Union Share Insurance Fund, insuring the savings of 80 million account holders in all federal credit unions and many state-chartered credit unions.
<b>Office of the Comptroller of the Currency</b>	The Office of the Comptroller of the Currency established in 1863, as a bureau of the U.S. Department of the Treasury, charters, regulates, and supervises all national banks. It also supervises the federal branches and agencies of foreign banks.
<b>Office of Thrift Supervision</b>	The Office of Thrift Supervision (OTS) is the primary regulator of all federally chartered and many state-chartered thrift institutions, which include savings banks and savings and loan associations. OTS was established as a bureau of the U.S. Department of the Treasury on August 9, 1989.
<b>Physical Presence</b>	A place of business that is maintained by a foreign bank and is located at a fixed address, other than solely an electronic address, in a country in which the foreign bank is authorized to conduct banking activities, at which location the foreign bank: (1) employs one or more individuals on a full-time basis, (2) maintains operating records related to its banking activities, and (3) is subject to inspection by the banking authority that licensed the foreign bank to conduct banking activities.
<b>Primary Federal Regulator</b>	<p>There are four federal regulators of banks and savings and loan institutions:</p> <ul style="list-style-type: none"> <li>• Federal Deposit Insurance Corporation (FDIC) - Primary federal regulator responsible for state-chartered banks not members of the Federal Reserve System and state-chartered savings banks.</li> <li>• Board of Governors of the Federal Reserve System (FRB) - Primary federal regulator responsible for state-chartered commercial bank members of the Federal Reserve System.</li> <li>• Office of the Comptroller of the Currency (OCC) - Primary federal regulator responsible for nationally chartered commercial banks.</li> <li>• Office of Thrift Supervision (OTS) - Primary federal regulator responsible for federally chartered savings and loan associations, federal savings banks, and state-chartered savings and loan associations.</li> </ul>
<b>Private Banking Accounts</b>	An account (or any combination of accounts) that (1) requires a minimum aggregate of deposits or funds or other assets of not less than \$1 million, (2) is established on behalf of one or more individuals who have direct or beneficial ownership interest in the account, and (3) is assigned to or is administered or managed, in whole or in part, by an officer, employee, or agent of a financial institution acting as a liaison between the financial institution and the direct or beneficial owner of the account.

## GLOSSARY

Term	Definition
<b>Proposed Rule</b>	Proposed rules provide notices to the public of the proposed issuance of rule and regulations. The purpose is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules. Proposed rules may suggest changes to agency regulations in the C.F.R.; request public comment on those suggested changes; relate to previously published proposed rules; extend the comments period; announce a public hearing; make available supplemental information, withdraw a proposed rule; or correct a previously published proposed rule.
<b>Risk-Focused Examination Process</b>	The risk-focused examination process attempts to assess an institution's risk by evaluating its processes to identify, measure, monitor, and control risk. The risk-focused examination process seeks to strike an appropriate balance between evaluating the condition of an institution at a certain point in time and evaluating the soundness of the institution's processes for managing risk.
<b>Rulemaking Process</b>	<p>The Secretary of the Treasury issues proposed, interim, and final rules in the Federal Register. Most rules are keyed to and codified in the C.F.R.</p> <ul style="list-style-type: none"> <li>• Proposed rule: Provides notices to the public of the proposed issuance of rule and regulations; the purpose is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules; may suggest changes to agency regulations in the C.F.R. and request public comment on those suggested changes; and may relate to previously published proposed rules, extending the comments period, announcing a public hearing, making available supplemental information, withdrawing a proposed rule, or correcting a previously published proposed rule.</li> <li>• Interim rule: Issued without prior notice and is effective immediately; the interim rule is designed to respond to an emergency situation and is usually followed by a final rule document which confirms that the interim rule is final, addresses comments received, and includes an further amendments.</li> <li>• Final rule: Generally, issued to amend a C.F.R. by adding, removing, or revising text; makes a previously issued proposed rule final; or may take final action without a prior proposed rule being issued. Final rules are usually effective at least 30 days</li> </ul>

## GLOSSARY

Term	Definition
	after the date of publication, in most cases; at least 60 days after the date of publication for major rules; or on the date of publication in response to an emergency.
<b>Safety and Soundness Examinations</b>	These periodic, on-premise examinations help assess an institution's financial condition, policies and procedures, and adherence to laws and regulations. These examinations are a vital tool in protecting the financial integrity of the deposit insurance funds and promoting public confidence in the banking system and individual banks.
<b>Secretary</b>	The Secretary of the Treasury or any person duly authorized by the Secretary to perform the function mentioned.
<b>Securities and Exchange Commission</b>	The U.S. Securities and Exchange Commission (SEC) was established in 1934 and has a primary mission to protect investors and maintain the integrity of the securities markets. The SEC also oversees other key participants in the securities world, including stock exchanges, broker-dealers, investment advisors, mutual funds, and public utility holding companies.
<b>Shell Banks</b>	Financial institutions that do not have a physical presence in the United States. Physical presence refers to a place of business that is maintained by a foreign bank and is located at a fixed address other than solely an electronic address in a country in which the foreign bank is authorized to conduct banking activities.
<b>Special Use Accounts</b>	In-house accounts established to facilitate the processing and the settlement of multiple or individual customer transactions within the bank, usually on the same day. These accounts have several different names, including concentration, omnibus, suspense, settlement, intra-day, sweep, and collection accounts and are widely used in private banking, wire transfer, and other bank departments.
<b>Suspicious Activity Report</b>	<p>A suspicious activity report (SAR) must be filed when there are suspicions that a financial transaction falls into one or more of the following:</p> <ul style="list-style-type: none"> <li>• Money is derived from illegal activity, or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity.</li> <li>• Is designed to evade BSA requirements, whether through structuring or other means.</li> <li>• Serves no business or apparent lawful purpose, and the financial institution can determine no reasonable explanation for the transaction after examining all available facts.</li> </ul>

## GLOSSARY

Term	Definition
<b>Terrorism</b>	An act of terrorism can include both domestic and international actions that (1) involve acts dangerous to human life that violate criminal laws of the United States or of any state; (2) appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion, or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and (3) occur primarily within the territorial jurisdiction of the United States.
<b>USA PATRIOT Act</b>	The <i>United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001</i> , also known as the USA PATRIOT Act. The USA PATRIOT Act was enacted on October 26, 2001, and is directed primarily at anti-terrorism. Title III of the Act contains several new anti-money laundering provisions that affect financial institutions. The Secretary of the Treasury has the authority to impose provisions under this Act on financial institutions. The Act expands requirements that are included under the Bank Secrecy Act of 1970.



Federal Deposit Insurance Corporation

550 17th Street, NW, Washington, DC 20429

Division of Supervision and Consumer Protection

August 26, 2003

**MEMORANDUM TO:** Stephen M. Beard  
Deputy Assistant Inspector General for Audits

**FROM:** Michael J. Zamorski, Director *Michael J. Zamorski*  
Division of Supervision and Consumer Protection

**SUBJECT:** Draft Report Entitled *FDIC's Implementation of the USA PATRIOT Act* (Assignment Number 2003-036)

The Division of Supervision and Consumer Protection ("DSC") appreciates the opportunity to respond to the Office of the Inspector General's ("OIG") draft report regarding the FDIC's Implementation of the USA PATRIOT Act.<sup>1</sup> The overall objective of the audit was to "determine whether the FDIC has developed and implemented adequate procedures to examine financial institutions' compliance with the USA PATRIOT Act. The draft audit report concludes with two recommendations:

1. *Issue interim examination procedures for those sections for which the Treasury Department has already issued final rules—Title III Sections 313, 314, 319, and 326.*

**DSC RESPONSE:**

DSC agrees with the recommendation and issued interim guidance on August 15, 2003, entitled Bank Secrecy Act Examination Procedures (attached). The guidance, which was effective on the date of issuance, was distributed to all FDIC examiners. Additionally, the guidance was reviewed by the audit team and deemed to address all relevant sections of the USA PATRIOT Act. In the revised guidance (hereafter referred to as BSA Examination Procedures), the following relevant Sections of the USA PATRIOT Act are covered:

- Section 311. Special Measures for Financial Institutions. BSA Examination Procedures direct examiners to ensure financial institution compliance if special measures have been imposed by the Treasury Department against a foreign

<sup>1</sup> USA PATRIOT Act is the acronym for "United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001."

jurisdiction, institution, class of transaction(s), or type of account as a primary money laundering concern. If so designated, then the financial institution must take appropriate steps to comply with the special measures imposed by the Treasury.

- Section 312, Special Due Diligence. BSA Examination Procedures include steps to review a financial institution's due diligence related to private banking customers and internal correspondent banking relationships.
- Sections 313 and 319, Prohibition on U.S. Correspondent Accounts. BSA Examination Procedures direct examiners to evaluate a financial institution's process to identify suspicious activity in foreign correspondent accounts and includes measures for examiners to confirm that the financial institution has obtained the required documentation on foreign correspondent accounts within 30 calendar days after the date the account is established. Furthermore, the procedures require that the documentation should verify that the foreign correspondent bank is not a foreign shell bank and the U.S. correspondent account is not used to indirectly provide services to foreign shell banks. The guidance also instructs examiners to ensure that a financial institution documents procedures for closing or terminating foreign correspondent accounts, recertifying required documentation, and responding to written requests from federal law enforcement officers.
- Section 314, Cooperative Efforts to Deter Money Laundering. BSA Examination Procedures require that examiners confirm whether financial institutions have programs to comply with Section 314(a) information requests, which include the following:
  - designation of an employee as the contact person responsible for handling Section 314(a) information requests;
  - procedures to ensure that all required records are searched, with positive hits reported to the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") within designated timeframes; and
  - appropriate records to document search results.
- Section 325, Concentration Accounts. BSA Examination Procedures include steps to review a financial institution's *special use* or *concentration* accounts. Procedures include confirming that financial institutions assess the adequacy of internal controls that have been implemented to ensure the proper use of *special use* or *concentration* accounts and reviewing the nature of account activity for any suspicious or unusual activity. Additionally, the guidance directs examiners to confirm that the financial institution's policy: (1) prohibits customers from directing the movement of funds through special use accounts; and (2) prohibits bank employees from disclosing the existence of a special use account to customers.
- Section 326, Verification of Identification. BSA Examination Procedures address reviewing bank account opening procedures and customer due diligence guidelines. Furthermore, the guidance directs examiners to confirm that the financial institution's

board of directors adopts a written customer identification program for new accounts that includes: (1) specified customer identification information; (2) identification verification procedures; and (3) recordkeeping and retention procedures.

- Section 352, Anti-Money Laundering Programs. BSA Examination Procedures require examiners to determine if a financial institution has adopted a written anti-money laundering program. The guidance directs examiners to determine whether the program contains a system of internal controls, independent testing for compliance, a designated qualified individual responsible for coordinating and monitoring daily compliance, and training for appropriate personnel.
2. *Work with the FDIC-FRS-CSBS Steering Committee for Risk Focused Examination Procedures and Supporting Software to issue examination guidelines concurrently with the Treasury Department's issuance of final rules for institutions' implementation of Title III provisions.*

**DSC RESPONSE:**

DSC agrees with the recommendation and is working with the Federal Reserve Board ("FRB") and the Conference of State Bank Supervisors ("CSBS") in the interagency examiner-guidance process. At the June 2003 Supervisory Process Committee Meeting, the Chairman of the Examination Documentation ("ED") Module Maintenance Committee (also an employee of the FRB) stated that the interagency guidance should be deferred for discussion until the November 2003 meeting for various reasons. Those reasons included additional rulemaking issues related to the USA PATRIOT Act and the length of time required to update the ED module application. As a result, DSC immediately began the process of issuing interim guidance to DSC examiners. That guidance was issued August 15, 2003, a full 46 days before the planned completion date of September 30, 2003.

**DSC Action:**

DSC has a representative member on the Supervisory Process Committee. The member will raise the interagency examination guideline recommendations contained in this Report at the next scheduled meeting. This action will be completed no later than March 31, 2004.

**SUMMARY OF DSC RESPONSE TO RECOMMENDATIONS**

The revised BSA Examination Procedures, which were issued August 15, 2003, address all relevant provisions of the USA PATRIOT Act, and therefore satisfy the first recommendation. Additionally, interagency coordination has appropriately been referred to and is being handled by DSC's Policy Branch. Although the interagency process is not within the control of DSC alone, we have proactively issued interim guidance that meets the needs of DSC staff as well as institutions regulated directly

by the FDIC. Therefore, DSC believes that it has satisfactorily responded to the second recommendation.

**GENERAL COMMENTS**

In addition to issuing examiner guidance, DSC has issued six Financial Institution Letters (FILs) that address requirements of Sections 313, 319, 314, and 326. These FILs are directed to chief executive officers (CEOs) of state-chartered nonmember financial institutions, and DSC examiners receive copies of the FILs. Additionally, in October 2001, a confidential advisory was sent to CEOs of FDIC-supervised institutions to establish guidelines for communicating with the primary regulator and law enforcement; ultimately, this was the genesis for the Section 314(a) information-sharing process. Ongoing communications exist between DSC and state-chartered nonmember institutions related to Section 314(a) contact information and requirements. Finally, many regions have incorporated USA PATRIOT Act training into banker outreach programs and state banking regulatory conferences, while the Special Activities Section has provided specialized instruction at regional training conferences, trade group conferences and industry seminars, and to individual financial institutions and many foreign visitors. Overall, DSC has been proactive by participating in working groups that developed USA PATRIOT Act rules, providing technical assistance to bankers, and communicating USA PATRIOT Act requirements through various vehicles.

## MANAGEMENT RESPONSES TO RECOMMENDATIONS

This table presents the management responses that have been made on recommendations in our report and the status of recommendations as of the date of report issuance. The information in this table is based on management's written response to our report and subsequent communication with management representatives.

Rec. Number	Corrective Action: Taken or Planned/Status	Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Dispositioned: <sup>b</sup> Yes or No	Open or Closed <sup>c</sup>
1	DSC agreed with this recommendation. DSC issued interim guidance on August 15, 2003, entitled Bank Secrecy Act Examination Procedures. The guidance, which was effective on the date of issuance, was distributed to all FDIC examiners. This recommendation is considered resolved, dispositioned, and closed.	August 15, 2003	\$0	Yes	Yes	Closed
2	DSC agreed with the recommendation. DSC is working with the Federal Reserve Board (FRB) and the Conference of State Bank Supervisors (CSBS) in the interagency examiner-guidance process. DSC issued interim guidance to DSC examiners on August 15, 2003. This recommendation is considered resolved, dispositioned and closed.	August 15, 2003	\$0	Yes	Yes	Closed

<sup>a</sup>Resolved – (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.

(2) Management does not concur with the recommendation but planned alternative action is acceptable to the OIG.

(3) Management agrees to the OIG monetary benefits or a different amount, or no (\$0) amount. Monetary benefits are considered resolved as long as management provides an amount.

<sup>b</sup>Dispositioned – The agreed-upon corrective action must be implemented, determined to be effective, and the actual amounts of monetary benefits achieved through implementation identified. The OIG is responsible for determining whether the documentation provided by management is adequate to disposition the recommendation.

<sup>c</sup>Once the OIG disposes the recommendation, it can then be closed.